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ABSTRACT

Recent efforts by several states and colleges to establish new student loan programs are described, based in part on a policy seminar held in September 1982. Prospects and problems of the options are also considered. Several higher education institutions are developing loan programs that follow conventional financing methods and do not utilize federal subsidies. States have used a variety of approaches to finance alternative programs for student loans. Illinois, Massachusetts, Maryland, and Iowa have created a new authority for loans--single-purpose bond authorities to raise money for student loans through the sale of tax-exempt bonds. Expanding the mandate of existing bond authorities (e.g., for housing facilities) to include student loans is another approach. A third approach is the use of the state board of higher education. In addition, new federal loan programs--PLUS and ALAS (Parent Loans for Undergraduate Students and Auxiliary Loans to Assist Students)--may assume an important role as a supplement to the Guaranteed Student Loan Program. Areas of concern include the expense of conventional financing methods, tax-exempt bonds, and public policy issues. Criteria that might be useful for evaluating alternative loan options are identified. (SW)

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AMERICAN COUNCIL ON EDUCATION

Policy Brief

Division of Policy Analysis and Research — December 1982

STUDENT LOAN OPTIONS: WHAT IS HAPPENING?

Cecilia Ottinger

Introduction

Federal programs providing financial assistance to college students in the form of loans, particularly Guaranteed Student Loans (GSLs), grew significantly during the latter part of the seventies. With the advent of the Reagan Administration and its policy of government retrenchment in various social policy areas, the GSL program became a prime target for change. In FY 1982, families with incomes over $30,000 were required to meet a needs test, and an origination fee of five percent was imposed on all loans.

These program changes, together with proposed FY 1983 cuts, the rising costs of college tuition, and the contraction of other federal financial aid programs, have become causes for concern at many institutions of higher education. In addition, there is increasing evidence that many students exhaust their GSL eligibility[1] and face severe problems in meeting the rising costs of college education. These trends, and uncertainty over the direction of federal aid, have prompted a number of states and higher education institutions to find ways to supplement federal aid by developing their own programs for financing loans to students.

Arthur Hauptman has described a range of new initiatives currently underway in a recent publication entitled, "Financing Student Loans: The Search for Alternatives in the Face of Federal Contraction."[2] This series of financing alternatives prompted a recent policy seminar organized by the American Council on Education, the National Institute of Independent Colleges and Universities, and the Washington Office of The College Board and co-sponsored by the Association Council for Policy Analysis and Research.

The seminar was held at the Brookings Institution, Washington, D.C., on September 20, 1982. Panelists described recent institutional and state efforts to develop loan programs and offered comments on the prospects and problems of these options. Members of the panel included Wendell Holladay, Provost, Vanderbilt University; Diane Wilson, Director of Admissions and Financial Aid, Hood College; Joseph Cronin, President of the Massachusetts Higher Education Assistance Corporation; Michael Gort, Vice President, Lehman Brothers, Kuhn, Loeb, Inc.; Lawrence Gladieux, Executive Director, Washington Office of The College Board; Thomas Wolanin, Special Assistant to the President, Antioch University; Janet Hansen, Associate Director for Policy Analysis, Washington Office of The College Board; Julianne Still Thrift, Executive Director of the National Institute of Independent Colleges and Universities; Elaine El-Khawas, Director of Policy Analysis and Research, American Council on Education; and Arthur Hauptman, Consultant, Washington Office of The College Board. This report is based in large part on information and perspectives offered at the policy seminar.

Review of Recent Loan Efforts

Institutional Activities Several higher education institutions are developing loan programs that follow conventional financing methods. Such loans are financed by private lenders or, in some instances, by use of an institution's own funds; these methods do not utilize federal subsidies in any manner.

For example, Dickinson College[3] in Pennsylvania has pledged over the next ten years $1 million from endowment funds as capital to finance a loan program for those parents whose children are now ineligible for GSLs

The interest rate was set initially at 13 percent and will be reviewed annually; there is no in-school interest subsidy for these loans. An origination fee is charged to the borrower and the loan must be repaid within six years of graduation.

Eureka College[4] in Illinois is another school relying on conventional financing to build a loan program. The school has asked each of the alumni to give $1,250 in addition to regular contributions to the institution in order to establish a loan fund.

Vanderbilt University has begun a one-year trial program using $600,000 of its funds to establish a student loan program for academic year 1982–83. In planning this program, the university calculated that it had lost approximately $1 million due to federal student aid cutbacks. The university is financing the program through general reserve funds. This loan option was established to maintain enrollment stability until a more durable policy can be developed. The loans are designated primarily for incoming freshmen and first-year professional students, with the maximum amount of $2,000 for undergraduate and $5,000 for graduate students. These loans are allocated on the basis of need and each student must already have sought the maximum amount from GSL in order to qualify. In addition, each borrower is required to have a credit-worthy cosigner. The loans carry a nine percent interest rate, which accrues until the individual terminates student status; repayment of the money begins six months after graduation or when the borrower is no longer classified as a student. The minimum repayment amount is $50 per month and, at the conclusion of the first five-year period, the unpaid balance may be paid in full or refinanced for another five years with an interest charge at the current prime rate, but not less than nine percent. In this academic year the program provided funds for 250 borrowers, most of whom were graduate or professional school students.

STATE-LEVEL EFFORTS Currently, states are using a variety of approaches to finance alternative programs for student loans.[5] Illinois, Massachusetts, Maryland, and Iowa have created a new authority for loans. These are single-purpose bond authorities which will raise money for student loans through the sale of tax-exempt bonds. Experience has shown that a year's time is needed to establish such a new organization.

Expanding the mandate of existing bond authorities (e.g., for housing facilities) to include student loans is another approach. New Hampshire, Maine, and Rhode Island have chosen this route, which takes less time than the creation of a new authority. In addition, when using this approach, the college loan authority can be designated to make both the loans and the collections.

A third approach is the use of the state board of higher education, or the same authority that handles state scholarship programs, to administer loan programs. New Jersey and Kentucky have chosen this method, which saves time and relies on groups that have experience with financial aid programs.

To date, most state-level efforts have focused on ways to establish new loan authorities and to begin their operation. There are, however, a number of state-level activities that have moved beyond the initial stage, including those in:

New Hampshire—Under New Hampshire bond authority, Dartmouth College has sold $10 million in bonds during the summer of 1982 to finance loans over the next three years to students now ineligible for federal aid. St. Anselms, Franklin Pierce, and New Hampshire College are also planning a twenty-year bond issue. Students and parents considered credit-worthy will be able to obtain up to $40,000 in loans for a four-year program. Financial need will not be a determining factor.[6]

Massachusetts—Bentley College, Boston College, Boston University, Clark University, Harvard University, Massachusetts Institute of Technology, Mount Ida Junior College, Simmons College, Wellesley College, Wheaton College, and Worcester Polytechnic Institute, are planning to float a $30 million bond issue early in 1983 that will finance loans for parents/students who have exhausted GSL and Parents Loans for Undergraduate Students (PLUS) funds.

District of Columbia—Universities in the District of Columbia have received authorization from Congress to sell tax-exempt bonds to raise additional funds for student loans. George Washington University hopes to utilize bond revenues to develop a loan program by academic year 1983–84. The loans will be used as a last resort for students who have exhausted other types of financial assistance.

RECENT FEDERAL EFFORTS Seminar panelists also noted that two relatively new federal loan programs—PLUS and ALAS (Parent Loans for Undergraduate Students and Auxiliary Loans to Assist Students)—may assume an increasingly important role as a GSL supplement. In 1980, the PLUS program was authorized by Congress in order to expand financing options for parents of undergraduate students who were unable to meet the escalating costs of postsecondary study. In 1981, eligibility for the loans was extended to graduate/professional students as well as to self-supporting undergraduates. As of June 1982, 28,000 parents and students had received these loans totaling $71 million.[7]

The loans are financed by private capital and guaranteed by state agencies. The federal government reinsures the loans against the death, disability, default, or bankruptcy of the borrower.

Parents/graduate students may borrow up to $3000 annually and independent undergraduates may borrow up to $2500, with an interest rate tied to Treasury bill rates. The interest rates for PLUS loans made on or after November 1, 1982 will be 12 percent (lowered from 14 percent in previous months) due to the drop in Treasury bill rates over the past year.[8]

There is no in-school interest subsidy for PLUS/ALAS loans, and parents must begin payments for these loans within sixty days of disbursement. The PLUS/ALAS terms for students are the same as those for parents. However,

an exception is made for full-time students, who may, at the lender's option, defer repayment of the principal until they leave school.

Questions and Concerns

Panelists and other participants at the seminar presented a number of issues regarding the direction of recent efforts to develop loan options. Practical difficulties were mentioned, and a number of concerns were raised about the implications of new loan activities from the perspective of public policy. Participants reported, for instance, that conventional financing methods were very expensive. With current interest rates, it was difficult to offer loans attractive to students and their parents without simultaneously escalating financial risk or expense for the school. Seminar participants also noted that institutional commitments needed to guarantee student loans might adversely affect a school's other long-term plans, for example, the building of new facilities.

Tax-exempt bonds pose other problems. Many schools would find it difficult to obtain a good bond rating or to make the financial commitments necessary to participate in a bond offering. In Illinois, for example, schools must establish reserves and pledge a portion of their assets against the risk of excessive default. Combined approaches, which pool the resources of several schools, offer some benefits but also introduce problems of how schools should share costs and financial liability.

Several seminar participants voiced concerns about the prospect that a multiplicity of loan programs will develop, each with differing terms and conditions. Greater difficulties with loan collection might result, particularly if students and parents carry several types of loans. Differences in loan terms could create confusion, and the availability of different programs might also contribute an excessive burden of debt for students and their families.

Public policy issues of fairness and equity are raised by the prospect that such alternative loan programs will not be uniformly available. Some states have encouraged or sponsored such options while others have not. Students at public institutions may not have access to loans and loan terms available to students at private institutions. Further, several seminar participants predicted that many independent institutions will not have the financial resources to participate in such loan options, thus limiting availability to students at wealthier institutions. Consequently, students may find that schools they apply to offer widely different loan programs, terms, and interest rates.

These considerations led a number of seminar panelists to reaffirm the importance and validity of current loan programs, especially the GSL program. It remains the best loan program because it is available to all students, in all states, and in all types of institutions. By now the GSL program has a largely successful administrative structure and is generally understood by both students and lenders. As interest rates in the national economy have come down in recent months, federal costs for loan programs have been eased, and may be reduced even more by the continued decline in interest rates that many financial analysts have predicted.

Summary Seminar participants generally agreed that it is difficult to predict what will result from the diversity of efforts now underway to develop loan alternatives for students. To date, only one bond offering has been made, even though bond authorities and operating structures have been established in a number of states. The PLUS/ALAS programs have been slow to develop, with most of their loan activity so far appearing in only a few states. Other alternatives are also likely to emerge. In New York, for example, the state legislature considered a bill this fall that would provide interest-rate subsidies for students, rather than a separate loan program. Complicating all of these efforts, too, is the prospect that interest rates for all types of loans may be lowered.

However, viewed in a national context, it appears likely that most loan alternatives would operate as supplements to a strong federal program of student assistance. In FY 1981, loan volume under the federal GSL program equaled $7.7 billion.[9] Loan options now in place or being developed are quite small compared to the federal program's ability to meet the educational needs of more than 2.5 million students who presently borrow under the GSL program each year.[10] A recent report estimated that 600,000 graduate/professional students borrowed under the GSL program for academic year 1980–81.[11] So it appears that fully half of all graduate students rely on GSLs to finance their graduate studies.

At the same time, the actions to explore loan options offer evidence of the pressure being felt by college and state administrators from students who wish to enroll (or continue) in postsecondary study, but who are unable to meet their expenses through programs currently available. Notably, much of the pressure arises from students who already have borrowed the maximum allowed from the federal GSL program; at present, GSL loans are limited to $2,500 per academic year for undergraduates. For graduate/professional students the limit is $5,000 per academic year.

It is clear, too, that many institutions feel a responsibility to consider alternatives as they assess their own ability to offer financial aid to students and parents who face problems in meeting college costs. Average college expenses now total about $4428 at public institutions and $8569 at private institutions;[12] yet the average BEOG (Pell Grant) in 1981 was $905.

In view of threatened cuts in federal support for student financial assistance, colleges and universities are likely to continue to explore ways to offer supplemental sources of loan funds to their students. It is also likely that as new programs evolve progress will be made in solving problems found in the initial efforts discussed at the loan seminar. Arthur Hauptman has summarized key factors to be considered in assessing current or new efforts:

- Will loans be available for students who need

assistance and no longer have access to GSL?
- Will loan terms be affordable for students and their families who desire to borrow?
- Are loan servicing and collection procedures adequate to prevent the possibility of widespread default?
- Does the creation of multiple loan programs—federal, state, and institutional lead to a possibility of an excessive repayment burden?
- Will a multiplicity of student loan programs cause confusion for both borrowers and lenders?[13]

Another perspective has been offered in a recent paper by David Laird, Jr., who suggested that the following criteria would be useful when evaluating alternative loan options.

- *Volume*—The option should provide reasonable confidence that current and projected loan demand will be met.
- *Access to Students*—The option should assure that eligible students will be able to obtain loans regardless of their socio-economic status, year in school, type of institution attended, and place of residence.
- *Policy Control*—The option should preserve control over the principal policies and operation of the student loan program.
- *Relationship to Financial Aid Policy*—The option should permit the program to be coordinated with other statewide and federal student assistance policy and programs.
- *Cost*—The cost of the program should be tolerable for both the borrower as well as the operator of the program.
- *Quality Control*—The option should permit program management to maintain and promote effective performance standards in all program functions.
- *Cash Flow Integrity*—The option should offer confidence to the providers of the capital that the assumptions used to estimate program cash flow are prudent, reasonable, and reliable.[14]

These considerations pose a serious challenge to the development of new loan alternatives, but also point to the elements of program viability over the long run. Seminar participants were not optimistic that such challenges could be met successfully, especially in view of the financial commitments that must be made by colleges and universities. Further experience with loan options over the next year or so should show the extent to which successful options can be developed. As yet, however, the prospect remains that federal loan programs—especially the GSL and, eventually, the PLUS program—stand as the most realistic sources of loan assistance for the great majority of students needing to borrow money for postsecondary study.

Notes

1. That is, students need further loans but have borrowed the maximum amount allowed under GSL.
2. Hauptman, Arthur. "Financing Student Loans: The Search for Alternatives in the Face of Federal Contraction." Washington: The College Board, June 1982.
3. Curry, Cathy. "Mechanisms for Financing Student Loans." Washington: National Institute of Independent Colleges and Universities Clearinghouse on Loan Alternatives, 1982, unpublished.
4. Ibid.
5. Joseph Cronin of the Massachusetts Higher Education Assistance Corporation discussed these efforts at the Loan Seminar held at The Brookings Institution, Washington, D.C., on September 20, 1982.
6. *Alternative Loan Program Innovations in Education (ALPINE)*, Vol. 1, No. 5, September 1982. This newsletter reports on meetings and on state developments discussed by the Alternative Loan Program Task Force on the National Council of Higher Education Loan Programs.
7. Division of Governmental Relations, American Council on Education.
8. "Interest Rates Down—Student Loans to Cost Less." *Chronicle of Higher Education*, October 27, 1982.
9. Division of Governmental Relations, American Council on Education.
10. Ibid.
11. Hamer, Herbert J., Horch, Dwight H., and Davis, Susan. *Talented and Needy Graduate and Professional Students: A National Survey of People Who Applied for Need-Based Financial Aid to Attend Graduate or Professional School in 1980–81*. New Jersey: Educational Testing Service, April 1982, p. 81.
12. Division of Policy Analysis and Research, American Council on Education, based on data from NCES and The College Scholarship Services. Figures include costs for tuition, room and board, books, supplies, and personal expenses.
13. Hauptman, "Financing Student Loans," pp. 3–4.
14. Laird, David B., Jr. "Options for Supplemental Student Loans: A Discussion Paper," for the Consortium on Financing Higher Education, September 28, 1982. Springsted Incorporated.

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